13 DEC 2022

Fitch Rates Santa Clara Valley Water District, CA Water Utility WIFIA Loans 'AA+'; Outlook Stable

Fitch Ratings - San Francisco - 13 Dec 2022: Fitch Ratings has assigned a 'AA+' rating to the following obligations issued by the Santa Clara Valley Water District Public Facilities Financing Corporation, CA (the corporation) on behalf of the Santa Clara Valley Water District, CA (the district):

--$73.9 million Water Reliability Program - Project 1 Water Infrastructure Finance and Innovation Act (WIFIA Loan); and

--$91.6 million Water Reliability Program - Project 2 WIFIA Loan.

The proceeds of Project 1 WIFIA loan will be used to fund the Anderson Dam seismic retrofit and Anderson Dam Coyote Percolation Dam Replacement. The proceeds of the Project 2 WIFIA loan will be used to fund the Pacheco Reservoir Expansion. The loans are expected to close approximately the last week of January 2023.

In addition, Fitch has affirmed the 'AA+' ratings on the following district obligations:

--$75.3 million Safe Clean Water Program refunding revenue bonds series 2022A;

--$46.5 million Safe Clean Water Program revenue certificates of participation (COPs) series 2022B issued by the corporation on behalf of the district;

--$41.3 million Safe, Clean Water Program WIFIA loan;

--$442.5 million water system refunding revenue bonds, series 2016A, taxable 2016B, 2017A, 2019A, taxable 2019B, taxable 2019C, 2020A and taxable 2020B;

--$182.2 million water revenue certificates of participation (COPs), series 2016C, taxable 2016D, 2020C and taxable 2020D;

--$48.1 million flood control system refunding and improvement COPs, series 2012A and 2017A;

--Issuer Default Rating (IDR).

The Rating Outlook is Stable.

ANALYTICAL CONCLUSION

The 'AA+' WIFIA loan ratings, issue ratings and IDR reflect the district's very low leverage in the framework of very strong revenue defensibility and operating risk profiles (both assessed at 'aa'). Leverage, as measured by net adjusted debt to adjusted funds available for debt service (FADS) increased slightly to a still low 2.3x in fiscal 2021 with the issuance of additional debt after a five-year decline. However, the 'aa' financial profile assessment and rating take into consideration that leverage is expected to increase rapidly and could approach 6.0x in Fitch's stress scenario over the five-year horizon.

The rise in leverage reflects the district's $2.5 billion fiscal 2022-2026 capital improvement plan (CIP) and borrowing plans, which are increasing to fund several large projects, as well as a rate deferral for fiscal 2021. The cost estimate for the district's largest capital project, the expansion of the Pacheco Reservoir, is currently estimated at $2.5 billion with annual spending ramping up in a few years and continuing beyond the fiscal 2026 timeframe. In addition, the district is in the process of or is contemplating various other significant capital investments just outside the five-year horizon.

The district's largest customer, San Jose Water Company (SJWC) is not rated by Fitch, but benefits from a service area with very favorable demand characteristics, as evidenced by very high incomes and low unemployment relative to national averages. The district also has full ability to reallocate costs. Operating costs are low relative to water production despite reliance on imported water, and the district's life cycle ratio is low with robust capital spending compared with depreciation.

CREDIT PROFILE

The district is a wholesale water supplier and groundwater manager serving approximately two million residents within Santa Clara County. It is the local importer of water supplies from the federal Central Valley Project and the California State Water Project (SWP) to the county. The district also provides groundwater basin management, recycled water and flood control services. It owns and operates three water treatment plants and an advanced water purification plant, 18 recharge facilities and 10 reservoirs.

The county includes California's third largest city (San Jose; IDR AA+/Stable) and is home to major technology companies such as Apple Inc., Google Inc., Intel Corp., HP Inc., Cisco Systems Inc. and Ebay Inc. Approximately 60% of district-wide revenues are generated from wholesale water operations while approximately 40% are attributable to flood control and storm water management.

KEY RATING DRIVERS

Revenue Defensibility 'aa'

Unconditional Contracts, Very Favorable Service Area

The consolidated entity benefits from a diverse mix of wholesale water, groundwater extraction, property tax, parcel tax and assessment revenues. It further has the unlimited independent legal ability to adjust rates. SJWC is not rated by Fitch, but exhibits solid utility fundamentals and serves a very favorable service area.

Operating Risks 'aa'

Very Low Cost Burden; Robust Capital Investment Supports Moderate Life Cycle Ratio

Operating risk is very low with the operating cost burden well under Fitch's threshold of $6,500 per million gallons (mg) of water production. In addition, the life cycle ratio has been just 21% in each of the last five years, supported by high capital investment.

Financial Profile 'aa'

Very Low Leverage to Rise

Very low leverage is expected to increase given additional planned borrowing and increased capital spending, and could approach 6.0x over the five-year horizon. This trajectory is likely to continue given continued significant capital spending and borrowing plans beyond that period. The district's liquidity profile is robust and considered neutral to the rating.

Asymmetric Additive Risk Considerations

No asymmetric additive risk considerations affect the rating determination.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Although unlikely, given planned capex and debt, sustained leverage in Fitch's base and stress scenarios under 5.0x given stable revenue defensibility and operating risk assessments.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--Sustained increase in leverage approximating 7.0x or above in Fitch's base and stress scenarios given stable revenue defensibility and operating risk assessments;

--While not expected, sustained increase in operating cost burden such that cost per mg is greater than $6,500 could lead to a downward revision of the operating risk assessment.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

SECURITY

The Water Reliability Program WIFIA loans are payable from installment payments under the Installment Purchase Agreement from the district to the corporation, secured by a pledge of water utility system revenues, including rate stabilization reserves, special purpose funds, and project acquisition funds. The corporation has assigned its rights to receive installment payments from the district to the WIFIA lender.

The series 2022A bonds are secured by a pledge of the voter-approved Safe Clean Water parcel taxes, including investment earnings, rate stabilization reserves and contingency reserves. The series 2022B COPs are payable from installment payments under an Installment Purchase Agreement from the district to the corporation, secured by a pledge of the voter-approved Safe Clean Water parcel taxes, including investment earnings, rate stabilization reserves and contingency reserves.

The Safe, Clean Water Program WIFIA loan is payable from installment payments under the 2022 Installment Purchase Agreement from the district to the corporation, secured from a pledge of the voter-approved Safe Clean Water parcel taxes, including investment earnings, rate stabilization reserves and contingency reserves. The corporation has assigned its rights to receive installment payments from the district to the WIFIA lender.

The water system revenue bonds and water revenue COPs are payable from a second lien on net water revenues. The senior lien is closed with no outstanding debt. The flood control system refunding revenue bonds and revenue COPs are payable from a first lien on gross flood control system revenues, which include voter-approved benefit assessments.

Revenue Defensibility

Revenue defensibility is assessed at 'aa'. The district has independent legal ability to increase rates, can fully reallocate costs within its various business lines, and has demonstrated good rate discipline through consistent increases to support capital needs. All revenues are derived from very strong and stable sources, and revenues are relatively diverse. In fiscal 2021, approximately 56% of revenues were derived from water charges, 38% from property tax revenues, including the district's share of the 1% county-wide property tax, a special parcel tax, and voter-approved benefit assessments to fund flood control-related debt service obligations, and 4% from capital contributions.

The district charges different rates for agricultural and non-agricultural groundwater in two different zones, the northern and southern areas. The northern area is the more populated region with higher amounts of non-agricultural water use. In addition, the district charges treated water rates for contracted municipal and industrial water use with non-contract treated water available at the discretion of the district to reduce groundwater pumping to maintain local aquifer storage.

For fiscal year 2021 and beyond, the district added two additional groundwater zones in the southern portion. The district held most rates flat for fiscal 2021 due to coronavirus economic impacts and implemented a 9.1% increase in fiscal 2022 and 15% increase in fiscal 2023 for northern area groundwater.

Non-agricultural water rates for the northern portion have increased at a 10-year CAGR of 10.7%

through fiscal 2023, while treated water charges increased at a CAGR of 9.8%. The district estimates additional increases of 15% in fiscal years 2024 and 2025 followed by a 9.1% increase in 2026 for northern area groundwater. The sizable increases primarily reflect recovery of planned capital investments.

The district receives a share of the 1% county-wide property tax and levies voter approved taxes to fund capital and operating costs related to the SWP. Further, the district has a voter approved special parcel tax (Safe, Clean Water and Natural Flood Protection tax) to fund supply reliability and dam protection as well as flood management. The parcel tax was renewed by voters in November 2020 and does not have an expiration. Property taxes, such as the parcel tax, exhibit very little economic volatility and are not correlated with water revenues, helping to mute the impact of swings in water usage on the district's consolidated financial performance.

Property tax revenues exhibited stability during the Great Recession with only a modest decline of 2.3% in fiscal 2011 assessed value. Further, the district participates in the County's Teeter Plan, under which the district receives the entire amount of taxes levied and the county retains any interest and penalties associated with collection of delinquencies. The district's assessed value has grown at a CAGR of 5.9% over the past decade (ending fiscal 2021).

The district has water sales contracts with numerous water retailers through at least the life of all debt obligations for the construction of the district's water treatment and distribution facilities. The top 10 customers account for essentially 100% of water charges and 50% of total revenues. The largest customer, SJWC, an investor owned utility regulated by the California Public Utilities Commission, represents about 63% of water charges and a five-year average of 29% of total revenues over the same time period.

SJWC's water supply includes water purchased from the district under a master contract expiring in 2051, groundwater, surface water from watershed run-off and diversion and reclaimed water. SJWC serves over 1 million customers through approximately 231,000 connections over a 139 square mile area. Remaining customers are primarily municipalities and include the city of Santa Clara, City of San Jose, California Water Service and city of Sunnyvale.

Operating Risks

The district's operating risk is low and assessed at 'aa'. The operating cost burden, measuring total costs relative to water production, has remained under $4,500 the FYE fiscal 2021. Water production has remained relatively stable, averaging approximately 200 million gallons per day the last five years. On a consolidated basis, major cost categories include watershed stewardship spending, imported water costs and administrative costs. The operating cost burden should remain below Fitch's $6,500 per mg threshold for the 'aa' sub-assessment over at least the intermediate term.

The life cycle ratio is low at 21% in each of the last five years, supported by robust capital spending relative to depreciation averaging 492%. About two-thirds of the district-wide $2.5 billion fiscal 2022-2026 CIP will fund water supply projects, with the remainder designated for flood projection, mitigation, buildings and information technology. The CIP includes approximately $1.5 billion in borrowing. Of note, according to management, the district has not spent more than two-thirds of its total capital budget for the last three years. As such, future capital spending could come in lower than the current forecast, though this could be somewhat tempered by project cost inflation.

The largest project the district is undertaking is the Pacheco Reservoir expansion project that will increase storage capacity at the existing reservoir from 6,000 acre-feet (AF) to 140,000 AF. The current reservoir's capacity is limited by restrictions imposed by the Department of Safety of Dams (DOSD). The project cost totals about $2.5 billion and the district has been awarded a $504.1 million state grant (Proposition 1 Water Storage Investment Program grant from the California Water Commission) for the project.

The district estimates it will spend about $931 million for the expansion from fiscal years 2023-2027, with an additional $1.46 billion the following five years. The CIP assumes that up to 35% of the Pacheco Reservoir project will be funded by partners that are not yet determined. Further, the district has applied for a WIFIA loan totaling about $1.45 billion to partially fund the Pacheco Reservoir costs, and an additional approximately $579 million to fund the Anderson Dam and Coyote Percolation Dam costs.

Additional large projects in the CIP include the Anderson Dam Seismic Retrofit Project, which is owned and operated by the district and has capacity constraints imposed by the DOSD, and a purified water project. The dam project has increased in cost over the last several years to now total $1.2 billion, the majority of which will be spent over the next decade, primarily due to the Federal Energy Regulatory Commission required projects.

The purified water project, intended to develop up to 12,000 af/year of new purified water for potable reuse, is estimated at about $700 million with an RFP expected to be issued by the district in early 2023. According to management, it would be designed, built, operated, maintained, and financed via a public-private partnership.

The district's operating costs also include its participation in the proposed Delta Conveyance project, which would include a tunnel under the Sacramento-San Joaquin Bay Delta intended to increase water reliability for SWP contractors. The estimated total cost of the project is $15.9 billion, but the timeline and ultimate cost to the district are uncertain. Lastly, additional longer-term projects include participation in the Sites Reservoir Project and Los Vaqueros Reservoir expansion projects.

These reservoir projects, which are being developed by other agencies with uncertain timing and cost structures, would provide storage and additional water supply or improve conveyance infrastructure to benefit the district. The district has included participation in the LVR project in its projection, assuming 30,000 AF of district storage. It has not yet signed a service agreement, but expects to do so by the end of calendar year 2023.

Financial Profile

The district's leverage is favorable and declined over the last five years to a low 1.7x in fiscal 2020 due to an increase in cash and adjusted FADS before increasing modestly to 2.3x in fiscal 2021 with debt issuance. The liquidity profile is also favorable but is neutral to the assessment, with fiscal 2021 coverage of full obligations at 2.6x and days cash on hand at 934 days; Fitch calculated total debt service coverage for the year was 3.7x.

Fitch Analytical Stress Test (FAST)

The FAST considers the potential trend of key ratios in Fitch's base case and stress case over a five-year period. The stress case is designed to impose capital costs 10% above expected base case levels and evaluate potential variability in projected key ratios.

The FAST base case was informed by the district's operating projections and reasonable assumptions made by Fitch. These include groundwater production annual rate increases as noted above. Water demand is estimated to decrease in fiscal years 2022 and 2023 due to conservation, and then rebound in fiscal years 2024-2026.

The base case includes annual water purchase costs increasing at about 5% plus supplemental water purchases as well as a 2% annual escalator to property tax revenues. Operating expenses are assumed to increase at the three-year CAGR of 6.1%. The forecast also includes the full amount of capital spending and borrowing as per the district's CIP, although as noted actual spending has historically come in lower. Based on these assumptions, the base case indicates leverage increasing to over 5.0x by fiscal 2026 while the stress case indicates an increase to over 5.0x by fiscal 2025 and approaching 6.0x by fiscal 2026.

Asymmetric Additive Risk Considerations

No asymmetric additive risk considerations affect the rating determination.

Sources of Information

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Lumesis.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Fitch Ratings Analysts

Shannon Groff
Director

Primary Rating Analyst
+1 415 732 5628
Fitch Ratings, Inc. One Post Street, Suite 900 San Francisco, CA 94104

Teri Wenck, CPA
Director
Secondary Rating Analyst
+1 512 215 3742

Dennis Pidherny
Managing Director
Committee Chairperson
+1 212 908 0738

Media Contacts

Sandro Scenga
New York
+1 212 908 0278
sandro.scenga@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Santa Clara Valley Water District (CA) [General Government]	LT IDR	AA+	Affirmed		AA+
• Santa Clara Valley Water District (CA) /Issuer Default Rating/ 1 LT	LT	AA+	Affirmed		AA+

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• Santa Clara Valley Water District (CA) /Property Assessment - Parcel Tax/ 1 LT	LT	AA+	Affirmed		AA+
• Santa Clara Valley Water District (CA) /Property Assessment - Special Assessment/ 1 LT	LT	AA+	Affirmed		AA+
Santa Clara Valley Water District (CA) [Water, Sewer]					
• Santa Clara Valley Water	LT	AA+	Affirmed		AA+

ENTITY/DEBT	RATING			RECOVERY	PRIOR
District (CA) /Water & Sewer Revenues (2nd Lien)/1 LT					

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	⊙	◆
STABLE	⊙	

Applicable Criteria

Public Sector, Revenue-Supported Entities Rating Criteria (pub.01 Sep 2021) (including rating assumption sensitivity)

U.S. Water and Sewer Rating Criteria (pub.18 Mar 2021) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Santa Clara Valley Water District (CA)	EU Endorsed, UK Endorsed
Santa Clara Valley Water District (CA)	EU Endorsed, UK Endorsed

DISCLAIMER & DISCLOSURES

All Fitch Ratings (Fitch) credit ratings are subject to certain limitations and disclaimers. Please read these limitations and disclaimers by following this link: https://www.fitchratings.com/understandingcreditratings. In addition, the following https://www.fitchratings.com/rating-definitions-document details Fitch's rating definitions for each rating scale and rating categories, including definitions relating to default. ESMA and the FCA are required to publish historical default rates in a central repository in accordance with Articles 11(2) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 and The Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019 respectively.

Published ratings, criteria, and methodologies are available from this site at all times. Fitch's code of conduct, confidentiality, conflicts of interest, affiliate firewall, compliance, and other relevant policies and procedures are also available from the Code of Conduct section of this site. Directors and shareholders' relevant interests are available at https://www.fitchratings.com/site/regulatory. Fitch may have provided another permissible or ancillary service to the rated entity or its related third parties. Details of permissible or ancillary service(s) for which the lead analyst is based in an ESMA- or FCA-registered Fitch Ratings company (or branch of such a company) can be found on the entity summary page for this issuer on the Fitch Ratings website.

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

Endorsement policy

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.